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## The "Charitable" Privilege: Evaluating the Status of Property Tax Exemptions for Institutions of Purely Public Charity in Pennsylvania

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The “Charitable” Privilege: Evaluating the Status of  
Property Tax Exemptions for Institutions of Purely  
Public Charity in Pennsylvania

Rebecca L. Traylor\*

ABSTRACT

*Pennsylvania has historically exempted institutions of purely public charity from paying property taxes, though that practice is currently under fire from critics who argue many charities no longer warrant this exemption. Adding to this tension is a struggle between the Pennsylvania General Assembly and Pennsylvania Supreme Court over who has the power to define “institutions of purely public charity,” which has culminated in the introduction of Senate Bill 4, a proposed constitutional amendment which purports to give that power solely to the legislature. This article explores the evolution of institutions of purely public charity in Pennsylvania and explores the arguments surrounding Senate Bill 4. Additionally, the article particularly explains how Senate Bill 4 is contradictory to the intent of the original constitutional provision regarding institutions of purely public charity, which was intended to limit legislative abuse. The article also briefly describes problems of lost revenue due to property tax exemptions and concerns that many tax-exempt organizations no longer warrant that status, and concludes by exploring various measures that can be adopted to limit the existing criteria defining which institutions qualify as purely public charities.*

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## I. INTRODUCTION

For the last several years, there has scarcely been an issue more widely worried about, complained about, or debated about than money. With the economy arguably not what it once was, both individuals and local governments are finding new ways to raise money and to save money. One hotly contested avenue to do so has been to question the tax-exempt status of charities and other non-profits, many of which have historically been property tax-exempt. In Pennsylvania, which is home to numerous large charitable organizations that could potentially be liable for several million dollars if their tax-exempt statuses were to be revoked, these challenges mean a great deal. Complicating the issue even further is the growing concern that many of these charitable organizations are no longer actually "charitable," and therefore no longer warrant their charitable tax-exempt status. Consequently, the law of charitable property tax exemptions in Pennsylvania today is in quite a precarious position.

According to the Pennsylvania Constitution, “[t]he General Assembly *may* by law exempt from taxation . . . [i]nstitutions of purely public charity.”<sup>1</sup> Early case law contemplated these institutions of purely public charity as those entities possessing eleemosynary characteristics,<sup>2</sup> giving more gratuitously than for a price, and reserving no private or pecuniary return.<sup>3</sup> A basic premise of taxation is that “[t]axes are not penalties, but are contributions which all inhabitants are expected to make . . . for the support of the manifold activities of government.”<sup>4</sup> Therefore, institutions of purely public charity are exempted from making tax contributions because the charitable entity is providing a service to the public that the government would otherwise have to provide.<sup>5</sup> This has been commonly referred to as a “quid pro quo” between the institution and the government.<sup>6</sup> However, while the charity earns its exemption in part by providing benefits to both society and the government, many organizations that are not charitable also provide benefits to both society and the government.<sup>7</sup> As a result, Pennsylvania courts have continually clarified that institutions do not qualify for tax exemptions merely because they have good intentions.<sup>8</sup>

In the last several years, there has been a heated public debate over exactly what kinds of charitable institutions should qualify for tax exemptions.<sup>9</sup> One major concern that has in part propelled this

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1. PA. CONST. art. VIII, § 2(a)(v) (emphasis added).

2. *Young Men’s Christian Ass’n of Germantown v. City of Phila.*, 187 A. 204, 208 (Pa. 1936) (noting the court’s use of the word eleemosynary here means that the institution must have a charitable characteristic not found in private profit institutions).

3. *Trs. of Acad. of Protestant Episcopal Church v. Taylor*, 25 A. 55, 56 (Pa. 1892).

4. *YMCA of Germantown*, 187 A. at 210.

5. *Id.* In this early case, the court generally reasoned that “the exemption from taxation of institutions of public charity is founded on the fact that such a charity is assuming a share of the public burden.” *Id.* When an institution gives gratuitously, it relieves the government of some of its responsibilities. *See generally id.*

6. *Id.* (explaining the general idea that “[a]ny institution which by its charitable activities relieves the government of part of this burden is conferring a pecuniary benefit upon the body politic, and in receiving exemption from taxation it is merely being given a ‘quid pro quo’ for its services in providing something which otherwise the government would have to provide”).

7. *City of Wash. v. Bd. of Assessment Appeals of Wash. Cty.*, 704 A.2d 120, 126 (Pa. 1997) (Nigro, J., dissenting) (explaining that while many charitable institutions are valuable to society, many private entities are as well, and “[i]t does not logically follow that they are charitable”).

8. *See Hosp. Utilization Project v. Commonwealth*, 487 A.2d 1306, 1316 (Pa. 1985) (explaining that mere non-profit status does not mandate exemptions from taxation); *YMCA of Germantown*, 187 A. at 211 (stating that “[e]ven the most praiseworthy institutions must expect to support the government by paying taxes when it engages in commercial activities no matter how it uses the net proceeds of such activities”).

9. PA. DEPT OF THE AUDITOR GEN., *A Special Report: A Review of Potential Lost Revenue Due to Property Tax Exemptions* (Dec. 2014), [http://www.paauditor.gov/Media/Default/Reports/RPT\\_PropTaxExemptions\\_12182014\\_LGW2\\_Final2.pdf](http://www.paauditor.gov/Media/Default/Reports/RPT_PropTaxExemptions_12182014_LGW2_Final2.pdf) (“Pennsylvania is at a major

scrutiny is that increasingly “cash-strapped” municipalities are losing out on millions of dollars of revenue because tax-exempt organizations own so much of the real estate in the cities in which they are located.<sup>10</sup> In Pennsylvania, this issue is exacerbated by the fact that the state is a hotbed for institutions of higher education and massive hospital systems, both of which have historically been tax-exempt.<sup>11</sup> Furthermore, there is a concern that the tax-exempt institutions that own this real estate look less like eleemosynary entities that give gratuitously and more like large for-profit corporations.<sup>12</sup> Critics of some of these tax-exempt institutions argue that the institutions, among other things, no longer offer many free services;<sup>13</sup> generate huge profits not properly invested back into the

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crossroads in the decades-long debate over how to define and review the property-tax exempt status of nonprofit organizations.”); *Property Tax Exemptions Cost County Millions*, ALLEGHENY CTY. CONTROLLER CHELSA WAGNER’S TAXPAYER ALERTS (June 2012), <https://www.alleghenycontroller.com/admin/attachments/uploads/4441211ControllerChelsaWagnerTaxpayerAlertPropertyTaxExemptions.pdf> (“After decades of local governments in Pennsylvania questioning the tax exempt status of certain organizations, the question remains, ‘are these exemptions fair? In these challenging financial times, it is our duty and responsibility to address [these] questions.’”).

10. See PA. DEPT OF THE AUDITOR GEN., *supra* note 9. This report, released by the Pennsylvania Auditor General, provides taxpayers with data on “potential tax revenue from properties that are currently exempt from property taxes” in light of the mounting financial challenges facing counties, municipalities and school districts. *Id.* Table 2 shows that the total potential property tax liability for tax exempt properties in 2014, for example, is: \$619,732,732 in Allegheny County; \$164,500,125 in Bucks County; \$138,310,233 in Dauphin County; and \$75,478,602 in Erie County. *Id.* The tax-exempt properties considered by this chart include government owned properties, K–12 schools, churches, charitable organizations, hospitals, and higher education institutions. *Id.*

11. See generally *id.* For example, Table 3 also shows the total potential property tax liability for medical facilities with purely public charity status in 2014. *Id.* Those totals amount to: \$76,124,321 for Allegheny County; \$15,557,615 for Bucks County; \$16,512,001 for Dauphin County; and \$7,181,931 for Erie County. *Id.* See also *infra* notes 27 and 28.

12. See Loren D. Prescott, Jr., *Pennsylvania Charities, Tax Exemption, and the Institutions of Purely Public Charity Act*, 73 TEMP. L. REV. 951, 951–952 (2000) (noting the recent aggressive challenges to many tax-exempt charities in Pennsylvania and how there is a “public perception of most charities as wealthy”); Natasha Lindstrom, *Nonprofit tax break proposal in Pennsylvania divisive*, TRIBLIVE NEWS (Apr. 5, 2015), <http://triblive.com/news/allegheny/8091700-74/pennsylvania-nonprofits-amendment#axzz3nYZN35sE> (quoting City Controller Michael Lamb as stating “Pittsburgh is now home to mega nonprofits that look more like corporate empires than social service providers”); Chris Potter, *Views on taxing nonprofits aired at hearing on proposed Senate bill*, PITTSBURGH POST-GAZETTE (Mar. 13, 2015), <http://www.post-gazette.com/news/state/2015/03/13/Views-on-taxing-nonprofits-aided-at-hearing/stories/201503120217> (quoting City Controller Michael Lamb as stating “[t]here is a big difference between the community food bank ... and the corporate land bank that continues to take properties off our tax rolls”).

13. Elisabeth Rosenthal, *Benefits Questioned in Tax Breaks for Nonprofit Hospitals*, N.Y. TIMES (Dec. 16, 2013), [http://www.nytimes.com/2013/12/17/us/benefits-questioned-in-tax-breaks-for-nonprofit-hospitals.html?\\_r=1](http://www.nytimes.com/2013/12/17/us/benefits-questioned-in-tax-breaks-for-nonprofit-hospitals.html?_r=1) (quoting John D. Colombo, a professor of tax law at the University of Illinois Urbana–Champaign, who stated that “[t]he standard nonprofit hospital doesn’t act like a charity any more than Microsoft does—they also give some stuff away for free,” but that the hospital’s primary purpose is to provide health care for a fee).

company’s charitable purpose;<sup>14</sup> and pay their executives exorbitant sums of money.<sup>15</sup> In essence, the argument is that many of these “charitable” institutions are hardly distinguishable from the for-profit companies that they compete with.<sup>16</sup>

The issue of charitable tax exemptions has also become a major source of tension between the Pennsylvania Supreme Court and the General Assembly, specifically regarding who has the final say on defining “institutions of purely public charity.”<sup>17</sup> In response to *Mesivtah Eitz Chaim of Bobov, Incorporated v. Pike County Board of Assessment Appeals*, a Pennsylvania Supreme Court decision clarifying that organizations must meet the court’s definition of “institutions of purely public charity” before considering any criteria enacted by the General Assembly,<sup>18</sup> the Pennsylvania Legislature proposed a constitutional amendment designed to give it the sole power to determine the criteria for institutions of purely public charity.<sup>19</sup> Supporters of the proposed amendment, Senate Bill 4, believe that the amendment will eliminate the purported confusion caused by using the court’s criteria and will allow for more consistency and clarity in determining which organizations qualify as institutions of purely public charity.<sup>20</sup> However, those against the amendment

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14. *Id.* (discussing the argument that most hospitals are not providing the value of their tax exemptions in community benefit and the low average percent of operating costs spent on charity care and community benefit by hospitals).

15. Matt Krupnick & Jon Marcus, *Think university administrators’ salaries are high? Critics say their benefits are lavish*, HECHINGER REP. (Aug. 5, 2015), <http://hechingerreport.org/think-university-administrators-salaries-are-high-critics-say-their-benefits-are-lavish/> (discussing the practice that university presidents and top administrators receive high salaries, receive housing allowances, and receive other perks such as cars and club dues paid for).

16. See Prescott, *supra* note 12 and accompanying text.

17. Compare *Mesivtah Eitz Chaim of Bobov, Inc. v. Pike Cty. Bd. of Assessment Appeals*, 44 A.3d 3, 9 (Pa. 2012) (holding that an entity must first establish that it is an “institution of purely public charity” under the test established by the Pennsylvania Supreme Court before considering any statute in place by the legislature), with S.B. 4, P.N. 347, Session of 2015 (Pa. 2015) (proposing a constitutional amendment that would change the Pennsylvania Constitution to read “[t]he General Assembly may, by law . . . [e]stablish uniform standards and qualifications which shall be the criteria to determine qualifications as institutions of purely public charity”). See also Chris Potter & Rich Lord, *Pennsylvania bill debates definition of taxable charities*, PITTSBURGH POST-GAZETTE (Mar. 30, 2015), <http://www.post-gazette.com/news/state/2015/03/30/Pennsylvania-Senate-Bill-4-debates-definition-of-taxable-charities/stories/201503300012> (discussing the history of granting tax exemptions in Pennsylvania and the roles of the courts and the legislature in deciding questions of tax exemptions).

18. See *Mesivtah*, 44 A.3d at 9.

19. See S.B. 4, P.N. 347, Session of 2015 (Pa. 2015).

20. Rich Lord, *Proposed Pennsylvania tax-exemption amendment stalls*, PITTSBURGH POST-GAZETTE (Mar. 27, 2015, 12:00 AM), <http://www.post-gazette.com/news/state/2015/03/27/Proposed-Pennsylvania-tax-exemption-amendment-stalls/stories/201503270175> (discussing the argument made by nonprofits—supporters of the amendment—that they want clear standards and clarity to prevent frivolous challenges to their tax-exempt status).

worry that it will expand the legislature's power and make it easier for organizations to qualify for charitable tax exemptions.<sup>21</sup> Possibly even more worrisome is the proposed amendment's potential infringement on the doctrine of separation of powers, which prohibits the legislature from interfering with the court's role in interpreting the constitution.<sup>22</sup>

Part II of this comment will explore the evolution of what it means to be an institution of purely public charity in Pennsylvania. Part III will explain the arguments surrounding the proposed constitutional amendment, Senate Bill 4. Additionally, Part III will explain how the proposed amendment is contradictory to the intent of the original constitutional provision regarding institutions of purely public charity, which was intended to limit legislative abuse in granting tax exemptions. Part IV will briefly explain the problem of lost revenue due to property tax exemptions and explore the concern that many tax-exempt organizations no longer warrant charitable exemptions, and the arguments against those concerns. Finally, Part V will explore various measures that the Pennsylvania Legislature can adopt to limit the existing criteria defining which institutions qualify as purely public charities, as part of an effort to prevent institutions from qualifying for tax exemptions merely because they have good intentions.

## II. THE EVOLUTION OF "INSTITUTIONS OF PURELY PUBLIC CHARITY" IN PENNSYLVANIA

### A. *The Early Practice of Exemption by Special Legislative Grant*

The concept of granting tax exemptions to charitable organizations has existed in Pennsylvania for over one hundred years.<sup>23</sup> Before the Pennsylvania Constitution of 1874, tax exemptions were

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21. For example, "municipal officials, employees of taxing districts such as schools, and those who believe large nonprofits such as hospital systems and universities should pay taxes when they behave more like for-profits than charities[] fear the Legislature would curtail their ability to challenge tax exemptions," which would ultimately disadvantage local economies. *Id.*

22. See generally *Mesivtah*, 44 A.3d at 7. "While the General Assembly necessarily must attempt to interpret the Constitution in carrying out its duties, the judiciary is not bound to the legislative judgment concerning the proper interpretation of constitutional terms." *Id.* (internal quotation omitted). "The General Assembly cannot displace [the Pennsylvania Supreme Court's] interpretation of the Constitution because 'the ultimate power and authority to interpret the Pennsylvania Constitution rests with the Judiciary, and in particular with this Court.'" *Id.* (quoting *Stilp v. Commonwealth*, 905 A.2d 918, 948 (Pa. 2006)).

23. See generally *White v. Smith*, 42 A. 125 (Pa. 1899); *Donohugh's Appeal v. The Library Co. of Phila.*, 86 Pa. 306 (Pa. 1878). These are examples of early cases where the Pennsylvania Supreme Court decided issues of charitable tax-exemptions.

conferred by special legislative grants to property owned by hospitals, religious groups, educational institutions, and other private and corporate organizations.<sup>24</sup> Because the Pennsylvania Legislature could grant an exemption to any property it wanted, those special grants often resulted in favoritism, whereby exemptions were granted to some properties and not to others.<sup>25</sup> While a large majority of the exemptions granted went to true charities, as the Pennsylvania Supreme Court noted in *Donohugh’s Appeal*, “[s]ome of these were, at best, only private charities, and some of them . . . were not charities at all, but mere trading corporations for private and individual profit.”<sup>26</sup> This practice ceased, however, after the Pennsylvania Constitution of 1874 passed, which declared that tax exemptions should instead only be allowed by general law,<sup>27</sup> and when the Act of 1874 later specified for which particular classes of property.<sup>28</sup> As the court in *Donohugh’s Appeal* explained, this restriction on the power to grant tax exemptions evidenced the resolve

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24. *Donohugh’s Appeal*, 86 Pa. at 311–12. In *Donohugh’s Appeal*, the court explains the history of charitable tax exemptions in Pennsylvania and notes that the state legislature passed one hundred and thirty acts between 1850 and 1873 exempting private or corporate property from taxation that fell into the following categories: institutions of public benevolence for the poor; hospitals; literary, scientific and educational institutions; religious churches and parsonages; cemeteries or burial places; military institutions; institutions of private benevolence; and those other miscellaneous or doubtful cases. *Id.*

25. *Id.*; see also *White*, 42 A. at 125. The court in *White* stated that “[p]revious to the constitution and Act of 1874, the legislature, by special act, relieved from taxation just what property it saw fit, whether the property was charitable, religious, or even devoted solely to purposes of corporate or private gain.” *Id.* “The legislative habit had grown into a great abuse.” *Id.*

26. *Donohugh’s Appeal*, 86 Pa. at 311 (using cemeteries as an example). Moreover, Pennsylvania politics during the period leading up to the adoption of the Pennsylvania Constitution of 1874 was notorious for being corrupt. Donald Marritz, *Making Equality Matter (Again): The Prohibition Against Special Laws in the Pennsylvania Constitution*, 3 WIDENER J. PUB. L. 161, 187, 190 (1993). Most of the legislation enacted during this time was special legislation, which resulted in a “[g]overnment . . . corrupted by the ‘blight of special legislation which like a black mold spread its mycelium beneath the political surface.’” *Id.* Furthermore, during this period, “[t]he concentration of money held by private, powerful corporations exerted a disproportionate, if not all-consuming, influence on the legislature.” *Id.* at 186. The legislature often sacrificed the public interest for private or personal interests. *Id.*

27. *Donohugh’s Appeal*, 86 Pa. at 308. In *Donohugh’s Appeal*, the court states:

Article 9, section 1, of the new constitution of Pennsylvania [of 1874] declares “[a]ll taxes shall be uniform upon the same class of subjects within the territorial limits of the authority levying the tax, and shall be levied and collected under general laws; but the General Assembly may, by general laws, exempt from taxation public property used for public purposes, actual places of religious worship, places of burial not used or held for private or corporate profit[,] and institutions of purely public charity.”

*Id.*

28. *Id.* at 308–309. The court notes:

The Act of May 14th 1874, Pamph. L. 158, passed to carry into effect this constitutional provision, provides that “all churches, meeting-houses, or other regular places of stated worship, with the grounds thereto annexed, necessary for the oc-



to abolish the favoritism that resulted from special legislation and to put "a limit upon the legislative power to exempt which was before unlimited."<sup>29</sup> Furthermore, by abolishing exemptions by special legislation, courts could only determine if a property qualified for a tax exemption as an institution of purely public charity by undertaking the difficult task of looking to the particular facts of the case.<sup>30</sup>

### *B. The Pennsylvania Supreme Court Fashions the HUP Criteria*

While the Pennsylvania Constitution of 1874 and Act of 1874 laid a framework for the law on charitable tax exemptions, neither defined "institution of purely public charity," and certain criteria, at times conflicting, later developed through case law.<sup>31</sup> In a landmark charitable tax exemption case decided in 1985, *Hospital Utilization Project v. Commonwealth* ("HUP"), the Pennsylvania Supreme Court chronicled the various criteria Pennsylvania courts had used over the past one hundred years to define institutions of purely public charity.<sup>32</sup> For example, early case law required that the benefits resulting from a charitable institution's acts must go to the public, and that the institution could reserve no private or pecuniary return.<sup>33</sup> Additionally, Pennsylvania courts had also held that "[w]hat is 'given' must be more nearly gratuitous than for a price" and that a charitable organization must render services to those that are "legitimate subjects of charity."<sup>34</sup> Further, in *HUP*,

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cupancy and enjoyment of the same; all burial-grounds not used or held for private or corporate profit; all hospitals, universities, colleges, seminaries, academies, associations, and institutions of learning, benevolence or charity, with the grounds thereto annexed, and necessary for the occupancy and enjoyment of the same, founded, endowed, and maintained by public or private charity" together with public school-houses, court-houses, jails, &c., are hereby exempted from all and every county, city, borough, road, and school tax, with a proviso that the exemption shall not extend to property not in actual use for the purposes specified, and from which any income or revenue is derived.

*Id.*

29. *Id.* at 312; see also *White*, 42 A. at 125–26. Furthermore, because the Pennsylvania Constitution of 1874 "was drafted in an atmosphere of extreme distrust of the legislative body and of fear of the growing power of corporations . . . [l]egislative reform was truly the dominant motif of the convention and that purpose is woven into the very fabric of the constitution." Marritz, *supra* note 26, at 191.

30. *White*, 42 A. at 126.

31. See *Hosp. Utilization Project v. Commonwealth*, 487 A.2d 1306, 1312–14 (Pa. 1985); see also *White*, 42 A. at 126 (stating that "the varying facts presented by the different cases resulted in apparently conflicting legal conclusions as to the application of the designation [of purely public charity]").

32. *HUP*, 487 A.2d at 1312–17.

33. *Id.* at 1312–13 (citing *Episcopal Acad. v. Phila.*, 25 A. 55, 56 (Pa. 1892)).

34. *Id.* at 1313–14 (quoting *Young Men's Christian Ass'n of Germantown v. City of Phila.*, 187 A. 204, 208 (Pa. 1936)).

the court also mentioned the idea of the “quid pro quo” and that “[t]he measure of an institution’s gratuitous aid to those requiring it is the measure by which the government is relieved of its responsibilities.”<sup>35</sup>

In *HUP*, the court’s analysis of the historical considerations used to determine if an organization qualified as an institution of purely public charity resulted in a new, five-part definition which succinctly captured the above-mentioned characteristics.<sup>36</sup> Under the *HUP* definition, an entity qualifies as an “institution of purely public charity” if it:

- (a) Advances a charitable purpose;
- (b) Donates or renders gratuitously a substantial portion of its services;
- (c) Benefits a substantial and indefinite class of persons who are legitimate subjects of charity;
- (d) Relieves the government of some of its burden; and
- (e) Operates entirely free from private profit motive.<sup>37</sup>

Following *HUP*, these five criteria became the test for determining institutions of purely public charity.<sup>38</sup>

The court’s analysis in the *HUP* case provides an excellent example of the application of the new criteria.<sup>39</sup> In *HUP*, the court explained that plaintiff, Hospital Utilization Project (“HUP”), a health record data processing company challenging the denial of its tax-exempt status,<sup>40</sup> was not charitable because: its mission to reduce operating costs at hospitals was not a gift to the general public;<sup>41</sup> HUP did not donate or render gratuitously any of its services because all of its clients paid fees approximating the actual costs of

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35. *Id.* at 1314 (quoting *YMCA of Germantown*, 187 A. at 210).

36. *Id.* at 1317.

37. *Id.*

38. *See* *Guthrie Clinic v. Sullivan Cty. Bd. of Assessment Appeals*, 898 A.2d 1194, 1198 (Pa. Commw. Ct. 2006) (stating generally that an institution must first demonstrate that it is a purely public charity by meeting the test set forth in *HUP*).

39. *HUP*, 487 A.2d at 1317–19.

40. *Id.* at 1307–08.

41. *Id.* at 1317. HUP is an organization, created by an association of hospitals, which prepares statistical abstracts of patient medical record data upon their discharge and provides the information to participating hospitals so that each institution can compare its statistics to those of other hospitals. *Id.* at 1309. HUP is not “charitable” in the legal sense,” and therefore failed to advance a charitable purpose. *Id.* at 1315.

the services;<sup>42</sup> and the hospitals and health care facilities that HUP serviced were not legitimate subjects of charity.<sup>43</sup> Additionally, the court concluded that HUP was not relieving the government of a burden because the type of research service it provided was not typically undertaken by the government<sup>44</sup> and, also, that HUP was not operating entirely free from private profit motive because its officers and directors were well-paid and the company generated a profit that it invested back into its operation.<sup>45</sup> As a result of these findings, the court held that HUP was not entitled to a property tax exemption as an institution of purely public charity.<sup>46</sup>

After the *HUP* criteria were established, many charitable organizations and local governments were uncertain about which entities still qualified as tax-exempt institutions of purely public charity.<sup>47</sup> Some commentators noted how the court's definition of "institution of purely public charity" after *HUP* established a "set of requirements more detailed and certainly less flexible than the approach previously used by the courts,"<sup>48</sup> which created confusion and resulted in increased litigation.<sup>49</sup> One reason in particular the *HUP* criteria may have been considered less flexible is because it became the only way of identifying institutions of purely public charity, from a test that "condense[d] over one hundred years of case

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42. *Id.* at 1317. The court noted that because clients must pay fees in order to receive the statistical reports, HUP's "operation is devoid of the eleemosynary characteristics generally associated with charitable organizations." *Id.* HUP therefore failed to donate or render gratuitously a substantial portion of its services. *Id.*

43. *Id.* The hospitals and health care facilities that HUP services are administrative entities, and are the ones who benefit from HUP's services by being able to cut operating costs after comparing what they do to other facilities. *Id.* Therefore, "[a]ny benefit to the sick or infirm is secondary and incidental. In this context, hospitals and health care services, some of which are operated for profit, do not fall within the genre of the poor, incapacitated, distressed or needy." *Id.* HUP therefore failed to benefit a substantial and indefinite class of persons who are legitimate subjects of charity. *Id.*

44. *Id.* at 1317 n.10. HUP therefore failed to relieve the government of some of its burden. *Id.*

45. *Id.* at 1317–18. In its analysis, the court also explained that "[i]n many respects it is difficult to distinguish HUP from any other commercial enterprise." *Id.* at 1318. HUP therefore failed to operate entirely free from private profit motive. *Id.* at 1317–18.

46. *Id.* at 1318.

47. See Prescott, *supra* note 12, at 957 (discussing generally the aftermath of the *HUP* decision); Patrick Sullivan, *Pennsylvania's Property Tax Exemption Might Go to Voters*, NONPROFIT TIMES (Sept. 13, 2013), <http://www.thenonprofittimes.com/news-articles/pennsylvania-property-tax-exemption-might-go-to-voters/> (explaining the "climate of uncertainty" surrounding tax exemption determinations and that the *HUP* test did not give organizations any guidance on how to meet or adhere to the criteria).

48. Prescott, *supra* note 12, at 957.

49. *Id.* See also Andy Carter, *PA History Shows the Wisdom of SB 4 and Nonprofit Tax Exemptions*, HOSP. AND HEALTHSYSTEM ASS'N OF PA. (Mar. 13, 2015), <https://www.haponline.org/Newsroom/Blog-Postings/ID/879/PA-History-Shows-the-Wisdom-of-SB-4-and-Nonprofit-Tax-Exemptions>.

law[.]”<sup>50</sup> Additionally, the resulting confusion was due in part to different courts in different parts of the state interpreting the *HUP* criteria differently and therefore ruling differently.<sup>51</sup> This consequently resulted in increased litigation, as is exemplified by The Hospital and Healthsystem Association of Pennsylvania’s (“HAP”) claim that “Pennsylvania courts presided over at least 20–25 ongoing legal challenges between *hospitals* and political subdivisions” alone.<sup>52</sup>

### C. *The Pennsylvania Legislature Institutes Act 55*

In recognition of the increasing confusion<sup>53</sup> and concern over the inconsistent application of the *HUP* criteria,<sup>54</sup> the Pennsylvania Legislature passed the Institutions of Purely Public Charities Act 55 (“Act 55”) in 1997.<sup>55</sup> Act 55 set much more detailed legislative standards for determining the eligibility of institutions of purely public charity, which could be applied uniformly throughout the state, thereby eliminating the inconsistent application of the *HUP* criteria, confusion among both the courts and the institutions themselves, and increased litigation stemming from the issue.<sup>56</sup> Similar to the five *HUP* criteria, Act 55 also included sections regarding charitable purpose,<sup>57</sup> private profit motive,<sup>58</sup> community service,<sup>59</sup> charity to persons,<sup>60</sup> and government service,<sup>61</sup> as the basis for its new detailed criteria for “institutions of purely public charity.”

However, while Act 55 principally reiterated and expanded upon the *HUP* criteria, it also noticeably “relaxed some of the requirements for meeting the HUP Test.”<sup>62</sup> In particular, Act 55 broadened

50. Prescott, *supra* note 12, at 957.

51. Carter, *supra* note 49.

52. *Id.* (emphasis added).

53. Institutions of Purely Public Charity Act, 10 PA. CONS. STAT. § 372(a)(4) (1997) (“(a) Findings . . . (4) Lack of specific legislative standards defining the term ‘institutions of purely public charity’ has led to increasing confusion and confrontation among traditionally tax-exempt institutions and political subdivisions to the detriment of the public.”).

54. *Id.* § 372(a)(5) (“(a) Findings . . . (5) There is increasing concern that the eligibility standards for charitable tax exemptions are being applied inconsistently, which may violate the uniformity provision of the Constitution of Pennsylvania”).

55. *Id.* §§ 371–385.

56. *Id.* § 372(b).

57. *Id.* § 375(b) (“The institution must advance a charitable purpose.”).

58. *Id.* § 375(c) (“The institution must operate entirely free from private profit motive.”).

59. *Id.* § 375(d)(1) (“The institution must donate or render gratuitously a substantial portion of its services.”).

60. *Id.* § 375(e)(1) (“The institution must benefit a substantial and indefinite class of persons who are legitimate subjects of charity.”).

61. *Id.* § 375(f) (“The institution must relieve the government of some of its burden.”).

62. PA. DEPT OF THE AUDITOR GEN., *supra* note 9, at 2. As explained below, this creates tension between the Pennsylvania Supreme Court and the Pennsylvania Legislature. *Id.*

prong (b) of the *HUP* test, that an institution “donate[] or render[] gratuitously a substantial portion of its services,” and prong (e), that it “[o]perate[] entirely free from private profit motive.”<sup>63</sup> For example, in *HUP*, the court explained that the determination of whether an organization satisfies the requirement that it donate or render gratuitously a substantial portion of its services is made by looking at the facts and circumstances of each case.<sup>64</sup> Yet, Act 55 implemented a bright-line test, allowing organizations to satisfy this prong by meeting “safe harbor” standards, such as only maintaining an open admissions policy or by simply offering some services at no charge to some portion of those served by the organization.<sup>65</sup> Additionally, Act 55 also significantly broadened the issue of compensation of officers, directors, and employees by requiring only that compensation may not be “based *primarily* on the financial performance of the institution[,]”<sup>66</sup> giving organizations substantial flexibility in creating compensation packages to reward executives and employees based on the financial performance of the institution.<sup>67</sup> Similarly, Act 55 ignored factors sometimes considered by courts when evaluating private profit motive, such as large advertising budgets or non-competition agreements, which are traditional markers of for-profit institutions.<sup>68</sup>

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The differences in criteria generate the issue of which definition of “institution of purely public charity” is supreme. *Id.*

63. *Hosp. Utilization Project v. Commonwealth*, 487 A.2d 1306, 1317 (Pa. 1985); *see also* 10 PA. CONS. STAT. § 375(c)–(d) (1997).

64. *HUP*, 487 A.2d at 1315 n.9. In this footnote, the court explains that:

Whether or not the portion donated or rendered gratuitous is “substantial” is a determination to be made based on the totality of circumstances surrounding the organization. The word “substantial” does not imply a magical percentage. It must appear from the facts that the organization makes a bona fide effort to service primarily those who cannot afford the usual fee.

*Id.* *See also* Prescott, *supra* note 12, at 964–66.

65. Prescott, *supra* note 12, at 966–71, 996–97. By offering a generous bright-line test instead of looking to the facts and circumstances of each case to determine if an institution is donating or rendering gratuitously a substantial portion of its services, the legislature expanded the opportunities for institutions to qualify. *Id.*

66. 10 PA. CONS. STAT. § 375(c)(3) (1997) (emphasis added).

67. Prescott, *supra* note 12, at 993 (requiring no close scrutiny of executive compensation, it is possible “[t]hat a charitable institution would commit resources otherwise available for charitable purposes to a business use such as executive compensation . . . leav[ing] some wondering about the current distinction between charities and commercial enterprise”).

68. *Id.* at 999–1001. *See also* Sch. Dist. of Erie v. Hamot Med. Ctr., 602 A.2d 407, 410–15 (Pa. Commw. Ct. 1992) (affirming the trial court’s conclusion that the organization had a private profit motive). In *Hamot*, the court found evidence of private profit motive, in part because “Hamot spent in excess of one million dollars in advertising in the 1987 fiscal year, over \$800,000 in the 1988 fiscal year and almost \$700,000 for the 1989 fiscal year” and further because “[i]ts community relations department is staffed by eleven persons and operates on an annual budget of over half a million dollars.” *Id.* at 411. *See also* Pinnacle Health Hosps. v. Dauphin Cty. Bd. of Assessment Appeals, 708 A.2d 1284, 1295 (Pa. Commw. Ct. 1998) (concluding that non-competition clauses are evidence of private profit motive).

As a result, Act 55 sharply divided those in favor and those against the new legislative standards. Proponents of Act 55 applauded the legislature, believing the bill provided clearer standards that could be uniformly applied, thus resulting in fewer disputes over an organization’s tax-exempt status<sup>69</sup> and providing the issue of charitable tax exemptions with much-needed stability.<sup>70</sup> Conversely, opponents of Act 55 maintained that the bill’s relaxed requirements resulted in an overall lenient test, under which almost any organization could qualify.<sup>71</sup> Notably, among the proponents of Act 55 were organizations such as the University of Pittsburgh Medical Center (“UPMC”), HAP, and the Pennsylvania State Alliance of YMCAs, which would benefit from a more lenient test, as opposed to those against Act 55, such as the local government taxing authorities.<sup>72</sup> Consequently, the issue of charitable tax exemptions was in flux and courts were left to grapple between the Pennsylvania Supreme Court’s stated *HUP* criteria and the General Assembly’s legislative standards laid out in Act 55.

*D. The Pennsylvania Supreme Court Declares the HUP Criteria Controlling in the Mesivtah Case*

The tension between the perceived, stricter *HUP* criteria and more lenient Act 55 standards came to a head before the Pennsylvania Supreme Court in 2012 in *Mesivtah Eitz Chaim of Bobov, Inc.*

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69. Carter, *supra* note 49. Proponents essentially believed that Act 55 accomplished its mission of reducing the negative consequences of the *HUP* criteria. *Id.* Under Act 55, “[t]he same clear, consistent standards for tax exemption applied to nonprofits across the entire state. Legal disputes about whether an organization should be tax exempt were few. Nonprofits (along with tax payers) were spared the uncertainty and legal costs of lengthy court battles and appeals processes.” *Id.*

70. Sullivan, *supra* note 47 (“[B]efore Act 55, it was a circus trying to operate without any level of predictability . . . . Act 55 provided stability and predictability.”).

71. Sean D. Hamill & Jonathan D. Silver, *Ruling ‘Game-Changer’ for Nonprofit Tax Status*, PITTSBURGH POST-GAZETTE (May 2, 2012, 2:54 PM), <http://www.post-gazette.com/business/businessnews/2012/05/02/Ruling-game-changer-for-nonprofit-tax-status/stories/201205020257>. “Act 55 swung the pendulum toward a more lenient test, and everybody who wanted exemptions was very happy about that and everybody who represents taxing authorities was unhappy about that,” said M. Janet Burkardt, an attorney with the Law Offices of Ira Weiss, solicitor for Pittsburgh Public Schools.” *Id.* For example, opponents argued that the fact that exempt-status cases were rarely challenged after the Act passed was actually evidence of Act 55’s leniency. *Id.*

72. See Allegheny County Public Meeting to Discuss Constitutional Amendment on Tax-Exempt Properties, *Public Charities Testimony*, PA. DEPT OF THE AUDITOR GEN. (Mar. 12, 2015), <http://www.paauditor.gov/Media/Default/Misc/FULL%20testimony%20list%20D2.pdf> (including transcripts of testimony of those in favor and opposed to Senate Bill 4, taken at a public meeting discussing the proposed amendment). UPMC is a very large hospital system primarily located in Western Pennsylvania. *UPMC Facts & Stats*, UNIVERSITY OF PITTSBURGH MEDICAL CENTER, <http://www.upmc.com/about/facts/pages/default.aspx> (last visited Dec. 26, 2016).

*v. Pike County Board of Assessment Appeals* (“*Mesivtah*”).<sup>73</sup> In *Mesivtah*, Mesivtah Eitz Chaim of Bobov, Incorporated, a nonprofit religious entity operating a summer camp that primarily offered classes on the Orthodox Jewish faith, appealed the Pike County Board of Assessment’s denial of its request for a charitable exemption from real estate taxes.<sup>74</sup> A central fact at issue in the case was that while the camp’s facilities were open to the public, no county residents used the facilities.<sup>75</sup> The trial court also denied the request for an exemption and the Commonwealth Court affirmed, applying the *HUP* criteria and explaining that there was insufficient evidence to prove the camp relieved the county government of some of its burden.<sup>76</sup>

On appeal before the Commonwealth Court, the charitable organization argued that because Act 55 defined “burden relieving” more expansively than the *HUP* test[,]” and because it met the standards set out in Act 55 which was enacted after *HUP*<sup>77</sup> and which thus displaced the *HUP* criteria,<sup>78</sup> it did not also need to satisfy the *HUP* criteria.<sup>79</sup> The county, on the other hand, argued that the *HUP* criteria had been applied even after Act 55’s enactment, and, further, that the doctrine of separation of powers prohibited the General Assembly from interfering with the court’s role in interpreting and defining the constitution—which it believed to be the case with Act 55.<sup>80</sup> Accordingly, the Pennsylvania Supreme Court was poised to address the conflict between *HUP* and Act 55 by answering definitively whether the General Assembly had the right to influence the constitutional definition of “institution of purely public charity” through its enactment of Act 55.<sup>81</sup>

As its answer, the Pennsylvania Supreme Court held that Act 55 does not replace the constitutional minimum set out in the *HUP* case.<sup>82</sup> More specifically, if an entity meets the constitutional interpretation of purely public charity encompassed by the *HUP* criteria, then it may qualify for an exemption if it also meets Act 55; *but*, if

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73. 44 A.3d 3 (Pa. 2012).

74. *Id.* at 5.

75. *Id.*

76. *Id.* This is prong (d) of the *HUP* criteria. See *Hosp. Utilization Project v. Commonwealth*, 487 A.2d 1306, 1317 (Pa. 1985).

77. *Mesivtah*, 44 A.3d at 6.

78. *Id.* at 6–7 (“It claims the *HUP* test was a stopgap measure displaced by the General Assembly’s definition[.]”).

79. *Id.* at 6 (“Appellant argued that it need not satisfy the *HUP* test, since the General Assembly enacted the Institutions of Purely Public Charity Act, 10 PA. CONS. STAT. §§ 371–385 (Act 55), after the *HUP* case was decided.”).

80. *Id.* at 7.

81. *Id.*

82. *Id.* at 9.

an entity does not first qualify for exemption under the *HUP* criteria, then Act 55 does not apply.<sup>83</sup> As part of its reasoning in holding the court’s definition controlling over that of the General Assembly, the court pointed out that no part of the Pennsylvania Constitution grants the General Assembly “non-reviewable authority” to decide what does or does not constitute an “institution of purely public charity.”<sup>84</sup> Furthermore, the court also returned to the idea that the Pennsylvania Constitution of 1874 was intended to limit legislative authority in granting tax exemptions.<sup>85</sup> The court reasoned that the result of the charitable organization’s argument would be that the General Assembly could then define whatever entity it wanted as an institution of purely public charity,<sup>86</sup> and that, in essence, would defeat the constitution’s very purpose of limiting legislative authority to grant tax exemptions.<sup>87</sup>

While the majority opinion in *Mesivtah* had resounding significance, Justice Saylor’s dissent also brought up important observations.<sup>88</sup> A large part of the dissenting opinion focused on the role of the legislature and the court in defining “institution of purely public charity.”<sup>89</sup> The dissent pointed out that the issue of charitable tax exemptions is a policy-oriented area where “legislative determinations [are] particularly important.”<sup>90</sup> Consequently, if Act 55 is otherwise in line with the constitution, Justice Saylor believed that the judiciary should defer to its standards, since Act 55 was the result of a reasonable policy-decision to have a more efficient and uniform

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83. *Id.* Specifically, the court held that a “party must meet the definition of ‘purely public charity’ as measured by the test in *HUP*” in order “to receive an exemption without violating the Constitution[.]” *Id.* “If it does so, it may qualify for exemption if it meets the statute’s requirements. Act 55, however, cannot excuse the constitutional minimum—if you do not qualify under the *HUP* test, you never get to the statute.” *Id.*

84. *Id.* at 8.

85. *Id.*

86. *Id.*

87. *Id.* The court elaborated, explaining:

Accordingly, Article VIII, § 2 was designed not to grant, but limit, legislative authority to create tax exemptions. To eliminate judicial review of the constitutionality of the General Assembly’s creations would defeat this purpose. The General Assembly could, by statute, define any entity whatsoever as an ‘institution of purely public charity’ entitled to exemption from taxes, returning to the practice the constitutional provision was designed to eliminate. It could create classifications of charities so oblique it would turn § 2 into an exception that swallows the uniformity requirement of Article VIII, § 1. Such a counterintuitive outcome would be contrary to Article VIII, § 2’s purpose of limiting the General Assembly’s ability to grant tax exemptions.

*Id.*

88. *See id.* at 9–11 (Saylor, J., dissenting).

89. *Id.* at 10.

90. *Id.*



application of the *HUP* criteria.<sup>91</sup> This argument becomes particularly important later on to those in favor of Senate Bill 4—the next critical event in the evolution of institutions of purely public charity in Pennsylvania.

### III. THE PROPOSAL OF SENATE BILL 4 AND ITS AFFECT ON THE EVOLUTION OF INSTITUTIONS OF PURELY PUBLIC CHARITY IN PENNSYLVANIA

The Pennsylvania Supreme Court's interpretation of what constitutes an institution of purely public charity now faces a new challenge by way of the introduction of Senate Bill 4.<sup>92</sup> Senate Bill 4, introduced in early 2013, is a proposed constitutional amendment to give the Pennsylvania Legislature the authority to determine the criteria for "institutions of purely public charity" regarding property tax exemptions.<sup>93</sup> The proposed amendment reads,

The General Assembly may, by law . . . [e]stablish uniform standards and qualifications which shall be the criteria to determine qualification as institutions of purely public charity. . . .<sup>94</sup>

Senate Bill 4 was introduced by Senators Mike Brubaker and Joseph Scarnati in reaction to the 2012 *Mesivtah* decision, and is intended to "clarify that it is the *exclusive role* of the General Assembly to write laws providing for the qualifications of institutions of purely public charity."<sup>95</sup> Though in *Mesivtah* the Pennsylvania Supreme Court was simply engaging in its right to constitutional interpretation, Senate Bill 4's sponsors take issue with how the court elevated its own judgment above that of the legislature, again caus-

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91. *Id.* at 11. Justice Saylor pointed out that "specifying additional criteria for each prong" through Act 55 did not "displace this Court's constitutional rulings or the *HUP* test in its entirety. Rather, the General Assembly determined—as a matter of policy—that more refinement was necessary for efficient, uniform application of that test and enacted legislation to serve that goal." *Id.*

92. See S.B. 4, P.N. 347, Session of 2015 (Pa. 2015).

93. *Id.*

94. *Id.*

95. Memorandum from Senator Mike Brubaker and Senator Joseph Scarnati on Purely Public Charities to All Pennsylvania Senate Members (January 28, 2013) [hereinafter Memorandum] (on file with the Pennsylvania State Senate) (emphasis added). This memorandum predates the introduction of Senate Bill 4, and details the proposal of Senators Mike Brubaker and Joseph Scarnati to reintroduce legislation regarding purely public charities (now referred to as Senate Bill 4). *Id.*

ing confusion regarding the criteria for purely public charity status.<sup>96</sup> Therefore, Senate Bill 4 is meant to preserve the legislature’s role as policymaker and to finally provide certainty in this area of the law.<sup>97</sup>

In Pennsylvania, proposed constitutional amendments must pass two two-year legislative sessions before being added to the general election ballot to be approved by Pennsylvania voters.<sup>98</sup> Senate Bill 4 passed the 2013–2014 legislative session and passed in the Senate in February 2015, and is now currently being considered by the House Finance Committee.<sup>99</sup> While there are many procedural obstacles in its path to becoming law, Senate Bill 4’s most formidable obstacle may be the bitter controversy that surrounds it.

Part of this controversy stems from the uncertainty surrounding the bill’s potential impact on the future of charitable property tax exemptions.<sup>100</sup> While the bill gives the General Assembly the power to establish standards for institutions of purely public charity,<sup>101</sup> it does not go beyond that and actually establish any standards.<sup>102</sup> In fact, as one news outlet reported, “[t]he uncertainty stems from what the amendment would not do. It would not change the definitions of purely public charities, nor the criteria set by the Legislature through the Institutions of Purely Public Charities Act 55 of 1997.”<sup>103</sup> The bill would give lawmakers the power to decide what to do next—keep Act 55 as it is, revise it, or develop a new set of standards governing tax exemptions for charitable institutions.<sup>104</sup> Or yet, as one commentator noted, Senate Bill 4 may do nothing, as the Pennsylvania Supreme Court would still be the final arbiter

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96. *Id.* (“By elevating its own judgment above the will of the General Assembly, the Court has created uncertainty as to the qualifications for public charities in Pennsylvania. Charitable organizations statewide could have their public charity status called into question based on this decision.”).

97. *Id.* (Senate Bill 4 is “legislation amending the Constitution to preserve the General Assembly’s role as policy maker in area of purely public charities and to provide certainty in this area of the law.”).

98. *Senate Bill 4 and the Determination of Purely Public Charity for PA Nonprofits*, FORBES FUND, <https://forbesfunds.org/state-taxation-issues> (last visited Dec. 28, 2015).

99. *Id.*

100. Lindstrom, *supra* note 12 (“Nobody is really sure what happens if the constitutional amendment passes—does the standard become more restrictive? Less restrictive?” [Auditor General Eugene] DePasquale said. ‘Nobody has any idea.’”).

101. S.B. 4, P.N. 347, Session of 2015 (Pa. 2015).

102. *Id.* The short text of the proposed legislation does not go beyond giving the General Assembly authority to establish standards. *Id.*

103. Lindstrom, *supra* note 12.

104. *Id.*

over the constitutional phrase “purely public charity.”<sup>105</sup> Nevertheless, despite this uncertainty surrounding the bill, there has been no shortage of vehement arguments raised both in favor and against Senate Bill 4 and its supposed consequences.

### A. *Arguments in Favor of Senate Bill 4*

Many of the arguments in favor of Senate Bill 4 and the General Assembly’s ability to set criteria for charitable tax exemptions echo those arguments that arose in favor of Act 55.<sup>106</sup> In fact, many of the strongest supporters of Senate Bill 4 include organizations that also supported Act 55, such as UPMC, HAP, and the Pennsylvania State Alliance of YMCAs—the beneficiaries of Act 55’s leniency.<sup>107</sup> Additionally, several of the arguments in favor of Senate Bill 4 seem to be founded in the belief that Act 55 will remain intact, or at least that the climate surrounding charitable tax exemption determinations will be consistent with the lenient climate after Act 55’s passage.<sup>108</sup>

For example, supporters of Senate Bill 4 likewise believe that the bill will create,<sup>109</sup> or restore,<sup>110</sup> a singular set of criteria that organizations can use to determine if they qualify as an institution of purely public charity or not.<sup>111</sup> A more detailed, singular set of criteria would result in a more objective and less complicated test, providing the clarity that many argue is absent when using the

105. See PA. DEPT OF THE AUDITOR GEN., *supra* note 72 (from the testimony of Dean Emeritus Nicholas P. Cafardi, Professor of Law at Duquesne University School of Law, on March 12, 2015) (stating that “[i]n our constitutional democracy, there is no such thing as a legislative act that is not able to be interpreted or reviewed by the third branch of government, the judiciary. Nor is there a phrase in the Pennsylvania Constitution that the judiciary cannot interpret”).

106. See Carter, *supra* note 49. Proponents essentially believed that Act 55 accomplished its mission of reducing the negative consequences of the HUP criteria. *Id.* Under Act 55, “[t]he same clear, consistent standards for tax exemption applied to nonprofits across the entire state. Legal disputes about whether an organization should be tax exempt were few. Nonprofits (along with tax payers) were spared the uncertainty and legal costs of lengthy court battles and appeals processes.” *Id.* See also Sullivan, *supra* note 47.

107. PA. DEPT OF THE AUDITOR GEN., *supra* note 72 (including transcripts of testimony of those in favor and opposed to Senate Bill 4, taken at a public meeting discussing the proposed amendment); Lindstrom, *supra* note 12; Lord, *supra* note 20.

108. This observation is based on the fact that support for Act 55 and Senate Bill 4 is largely one and the same in many respects, as is exemplified below. See also Hamill & Silver, *supra* note 71; PA. DEPT OF THE AUDITOR GEN., *supra* note 72 and accompanying text.

109. PA. DEPT OF THE AUDITOR GEN., *supra* note 72 (from the testimony of John W. Paul, President and CEO of Allegheny Health Network, on March 9, 2015).

110. *Id.* (from the testimony of the Pennsylvania State Alliance of YMCAs).

111. *Id.* (from the testimony of John W. Paul, President and CEO of Allegheny Health Network, on March 9, 2015 in support of Senate Bill 4) (“This bill simply aims to provide a law that will create a singular set of criteria, by which nonprofits can use to clearly determine if they need to pay taxes or provide community services.”).

court’s *HUP* test.<sup>112</sup> As it was, instituting a singular set of criteria that provided clarity was one of the most celebrated aspects of Act 55.<sup>113</sup> Clarity benefits larger organizations, which have been the most vocal in their support for Senate Bill 4, in addition to smaller organizations with fewer resources.<sup>114</sup> This is arguably because by continuing to apply the *HUP* criteria, which offers less guidance, on a case-by-case basis, the criteria will continue to be applied inconsistently across the state.<sup>115</sup> Such inconsistency, supporters say, leads to more costly litigation, which in turn results in higher costs for the nonprofit entity and which could then lead to job loss and/or reduced services and benefits.<sup>116</sup>

Supporters have also argued their support for Senate Bill 4 by showing the negative consequences of *not* adopting it. For example, some supporters maintain that by continuing under the court-imposed *HUP* criteria, nonprofit organizations will continue to face frivolous challenges,<sup>117</sup> which they believe will come from the “cash-strapped municipalities . . . using the court system against legitimate nonprofits to fill public coffers.”<sup>118</sup> A perceived frivolous challenge to an institution’s tax-exempt status could result in less collaboration between local taxing bodies and nonprofits, and hinder them working together to find solutions to some of the municipalities’ revenue issues.<sup>119</sup> Perhaps less persuasive is the Pennsylvania Association of Nonprofit Organizations’ argument in support of Senate Bill 4, which claims that passage of the bill will give them the ability to influence local elected officials to support their

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112. See Sullivan, *supra* note 47 (explaining the “climate of uncertainty” surrounding tax exemption determinations and that the *HUP* test did not give organizations any guidance on how to meet or adhere to the criteria).

113. *Id.* (“[B]efore Act 55, it was a circus trying to operate without any level of predictability’ . . . ‘Act 55 provided stability and predictability.’”).

114. PA. DEPT OF THE AUDITOR GEN., *supra* note 72 (from the testimony of Tom McGough, Executive Vice President and Chief Legal Officer of UPMC, on March 12, 2015) (“UPMC believes that a less complicated, more objective test for IPPC status would benefit smaller nonprofits, and particularly community hospitals . . .”).

115. *Id.* (from the testimony of Patricia J. Raffaele, Vice President of Professional Services as Hospital Council of Western Pennsylvania, on March 12, 2015) (“The current scenario—different courts rendering different opinions—is a barrier to clarity and consistency.”).

116. *Id.* Patricia J. Raffaele explained that “[c]ostly court cases, inconsistent decisions and the possibility of paying taxes will lead to continued erosion of our already financially fragile providers, especially in the rural areas of our region.” *Id.* Further, Raffaele noted that “[i]ncreased costs to any healthcare provider can and will lead to lost jobs and reduced community services and benefits relied on by many individuals and their families.” *Id.*

117. Lord, *supra* note 20.

118. Lindstrom, *supra* note 12.

119. PA. DEPT OF THE AUDITOR GEN., *supra* note 72 (from the testimony of Tom McGough, Executive Vice President and Chief Legal Officer of UPMC, on March 12, 2015) (stating that “combative challenges to large nonprofits are less likely to generate good results for local taxing bodies than are invitations to collaboration”).

cause.<sup>120</sup> Although it is impossible to know if Senate Bill 4 would actually result in these speculated outcomes, the unknown has not stopped supporters from continuing to loudly voice their approval of the bill.

### *B. Arguments against Senate Bill 4*

Much of the criticism surrounding Senate Bill 4 concerns the parties actually behind the bill's introduction, such as UPMC, Highmark, and HAP, repeatedly judged as "mega-charities" that look like for-profit corporations.<sup>121</sup> The Executive Director of Pittsburgh UNITED claimed that these "mega-charities" are supporting the bill because they fear "that some of their practices are threatened in a regulatory environment that asserts the *HUP* test as the qualification for exemptions, and not the more lax standards set out by Act 55."<sup>122</sup> Consequently, there seems to be a strong belief on both sides that the intent of Senate Bill 4 is to reduce accountability for nonprofit organizations.<sup>123</sup> However, those opposed to Senate Bill 4 instead claim that these charities should be held accountable "to the communities that subsidize them" and that when they are not held to a high standard, like the one imposed by the *HUP* criteria, "they burden people instead of lightening their load."<sup>124</sup> Such an

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120. *Id.* (from the written statement of Anne L. Gingerich, Executive Director, Pennsylvania Association of Nonprofit Organizations, on March 12, 2015) (stating that a positive outcome of Senate Bill 4 passing would be that "[n]onprofits could have the ability to influence their local delegation to support their cause"). Notably, this argument in favor of the ramifications of Senate Bill 4 is very reminiscent of the corruption and legislative abuse leading up to the adoption of the Pennsylvania Constitution of 1874. *See White v. Smith*, 42 A. 125 (Pa. 1899).

121. *See Lindstrom, supra* note 12 ("UPMC and Highmark join the Hospital Association of Pennsylvania in supporting SB 4"); PA. DEPT OF THE AUDITOR GEN., *supra* note 72 (from the testimony of Barney Oursler, Executive Director of Pittsburgh UNITED, on March 12, 2015) ("It's no secret the real movers behind amending the constitution to remove judicial oversight of purely public charities are not soup kitchens and small non-profits[.]").

122. PA. DEPT OF THE AUDITOR GEN., *supra* note 72 (from the testimony of Barney Oursler, Executive Director of Pittsburgh UNITED, on March 12, 2015). "Pittsburgh United is a coalition of community, labor, faith, and environmental organizations committed to advancing the vision of a community and economy that work for all people." PITTSBURGH UNITED, <http://pittsburghunited.org> (last visited Apr. 9, 2017).

123. PA. DEPT OF THE AUDITOR GEN., *supra* note 72 (from the testimony of Barney Oursler, Executive Director of Pittsburgh UNITED, on March 12, 2015) (Senate Bill 4 is an "amendment that today strikes me and many others in our community as a constitutionally guaranteed loophole for a few giant not-for-profits"). "[T]he intent and effect of the amendment is clear: to reduce accountability for mega-charities like UPMC." *Id.* (from the testimony of Lois Campbell, Executive Director of Pennsylvania Interfaith Impact Network, on March 12, 2015). "PANO, the organization of nonprofits in PA, has advocated for the amendment on the grounds that by returning us to the more lax regulatory environment of Act 55, charities are better shielded from challenge and accountability." *Id.*

124. *Id.* (from the testimony of Lois Campbell, Executive Director of Pennsylvania Interfaith Impact Network, on March 12, 2015). Lois Campbell also stated that "[w]hen charities

argument is based on the notion that when someone does not pay taxes, everyone else must pay more.<sup>125</sup> As a result, those opposed to Senate Bill 4 believe that the criteria for charitable tax exemptions should be narrow because tax exemptions are “a privilege, not a right.”<sup>126</sup>

Furthermore, while supporters of Senate Bill 4 believe that its non-adoption will lead to less collaboration between local governments and charitable organizations, it has been suggested that even under Act 55 and prior to *Mesivtah*, negotiations between local governments and large nonprofits were “basically a hat in hand begging exercise.”<sup>127</sup> It was the *Mesivtah* decision, which affirmed the superiority of the *HUP* criteria, which created a more equal footing for negotiations by giving local governments leverage.<sup>128</sup> Furthermore, the “explosion of opposition from municipal leaders, unions, police and fire associations, [and] school boards” is based on the worry about the legislature even further broadening the standards for charitable tax exemptions under Senate Bill 4, thus interfering with their ability to challenge tax exemptions.<sup>129</sup> While the cost of

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do not relieve government of burden, when they do not offer a significant portion of their services without charge, when they do not benefit everyone and do not operate entirely free of the private profit motive, . . . they create more problems than they solve.” *Id.*

125. *Id.* (from the testimony of Dean Emeritus Nicholas P. Cafardi, Professor of Law at Duquesne University School of Law, on March 12, 2015). See also ALLEGHENY CTY. CONTROLLER CHELSA WAGNER’S TAXPAYER ALERTS, *supra* note 9 (explaining that “[a]s property taxes are the main source of revenue for counties, municipalities, and school districts, exempt property decreases the total available taxable property that can generate revenue for these governments . . . [which] means that nonexempt, taxable properties bear a larger share of the total tax burden”); Daphne A. Kenyon & Adam H. Langley, *The Property-Tax Exemption for Nonprofits and Revenue Implications for Cities*, URBAN INST. 2 (Nov. 2011), <http://www.urban.org/sites/default/files/alfresco/publication-pdfs/412460-The-Property-Tax-Exemption-for-Nonprofits-and-Revenue-Implications-for-Cities.PDF> (explaining that exempting “nonprofits from property taxation means that homeowners and businesses must bear a greater share of the property tax burden”).

126. PA. DEPT OF THE AUDITOR GEN., *supra* note 72 (from the testimony of Dean Emeritus Nicholas P. Cafardi, Professor of Law at Duquesne University School of Law, on March 12, 2015). Tax exemptions are a privilege because the Pennsylvania Constitution says that “[a]ll taxes shall be uniform, upon the same class of subjects,” essentially meaning that everyone has to pay taxes. PA. CONST. art. VIII, § 1. An exemption from taxation is a privilege because one does not have to pay a tax that everyone else must pay. See generally *id.*

127. PA. DEPT OF THE AUDITOR GEN., *supra* note 72 (from the testimony of Michael Lamb, Pittsburgh City Controller, on March 12, 2015) (referring to negotiations for Payments in Lieu of Taxes). Payments in Lieu of Taxes (PILOTs) are voluntary payments made by tax-exempt nonprofits as a substitute for not paying property taxes. Kenyon & Langley, *supra* note 125, at 6. PILOT payments typically result from negotiations between local governments and the individual nonprofit organizations. *Id.*

128. PA. DEPT OF THE AUDITOR GEN., *supra* note 72 (from the testimony of Michael Lamb, Pittsburgh City Controller, on March 12, 2015) (explaining that, “[a]s a matter of tax fairness, having a more equal footing in this negotiation as provided in the *Bobov* ruling has helped municipalities across the state. It has given leverage where there was none before.”).

129. Lindstrom, *supra* note 12. Such groups argue that such a change would “make it too difficult for municipalities to challenge the status of nonprofits.” *Id.*

increased litigation may be a concern to some,<sup>130</sup> making it too difficult to challenge the status of so-called “institutions of purely public charity” could be detrimental to local economies. In particular, because non-profits own twenty to forty percent of properties throughout Pennsylvania,<sup>131</sup> limiting a local government’s ability to challenge suspect tax-exempt status could result in a significant amount of lost tax revenue.

One key argument critical of Senate Bill 4 focuses largely on the concern over the power that should be granted to the legislature. Specifically, while the language of Senate Bill 4 indicates that the General Assembly would like to become the “sole arbiter” over the issue of defining “institution of purely public charity,” the legislature simply cannot ignore nor pretend that legislative acts and constitutional phrases will always be subject to judicial review.<sup>132</sup> Moreover, as those suspicious of the consequences of Senate Bill 4 have explained, “if the intention of the bill is to reinstate Act 55, there is no need to transfer the power from the judiciary to the general assembly.”<sup>133</sup> Contrary to arguments in support of Senate Bill 4, transferring power to the legislature could lead to more “uncertainty from one legislative session to the next” and/or an “increased possibility of governmental overreach.”<sup>134</sup> Consequently, because

130. PA. DEPT OF THE AUDITOR GEN., *supra* note 72 (from the testimony of Patricia J. Raffaele, Vice President of Professional Services as Hospital Council of Western Pennsylvania, on March 12, 2015).

131. Lindstrom, *supra* note 12.

132. PA. DEPT OF THE AUDITOR GEN., *supra* note 72 (from the testimony of Dean Emeritus Nicholas P. Cafardi, Professor of Law at Duquesne University School of Law, on March 12, 2015). Dean Cafardi elaborated, explaining:

That authority [to decide what the conditions of tax exemption are] has historically resided with our state’s Supreme Court, as the interpreter of the Pennsylvania Constitution. The General Assembly, however, would like to change the status quo and become the sole arbiter in this case. It would like to set the conditions of tax exemption and say which institutions meet them, with no interference from the courts, and no review by the courts of their actions . . . I think that result would be contrary to the basic principles of our state government. In our constitutional democracy, there is no such thing as a legislative act that is not able to be interpreted or reviewed by the third branch of government, the judiciary. Nor is there a phrase in the Pennsylvania Constitution that the judiciary cannot interpret.

*Id.* The concept of judicial review refers to the power of a court to make decisions on the validity of an act of the legislature in relation to the Constitution. Edward S. Corwin, *Judicial Review in Action*, 74 U. PA. L. REV. 639 (1926). The power of judicial review is incidental to the court’s power to hear cases and controversies. *Id.*

133. PA. DEPT OF THE AUDITOR GEN., *supra* note 72 (from the testimony of the Greater Pittsburgh Nonprofit Partnership, on March 12, 2015).

134. *Id.* See also Donohugh’s Appeal, 86 Pa. 306, 311 (1878) (explaining that the Pennsylvania Constitution of 1874 establishing exemptions by general law was in part because of the problem that keeping the power in the hands of the legislature meant that “views of successive legislatures might be more or less liberal on the subject,” and this ultimately resulted in legislative abuse).

governmental overreach rings of legislative abuse, we return to a foundational principle of the legislature’s ability to grant charitable tax exemptions as established by the Pennsylvania Constitution of 1874.

### C. *Returning to the Concern of Legislative Abuse*

The proposed power to be granted to the Pennsylvania Legislature through Senate Bill 4 is reminiscent of the legislative abuse that the Pennsylvania Constitution of 1874 was designed to curtail.<sup>135</sup> The court in *Mesivtah* addressed this issue when it noted that:

Article VIII, § 2 was designed not to grant, but limit, legislative authority to create tax exemptions. To eliminate judicial review of the constitutionality of the General Assembly’s creations would defeat this purpose. The General Assembly could, by statute, define any entity whatsoever as an “institution of purely public charity” entitled to exemption from taxes, returning to the practice the constitutional provision was designed to eliminate.<sup>136</sup>

A grant of power on this scale, where the court’s criteria seemingly is taken out of the equation, like that proposed in Senate Bill 4,<sup>137</sup> could very well result in serious, negative consequences. Historically, leaving exemption determinations up to the General Assembly completely has proven to result in favoritism, whereby some organizations unfairly benefit while others do not.<sup>138</sup> Under Senate Bill 4, the legislature would be in a position to make entirely discretionary decisions, if there were no check on its power.<sup>139</sup> Again,

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135. See *White v. Smith*, 42 A. 125 (Pa. 1899). “Previous to the constitution and Act of 1874, the legislature, by special act, relieved from taxation just what property it saw fit, whether the property was charitable, religious, or even devoted solely to purposes of corporate or private gain. The legislative habit had grown into a great abuse.” *Id.* During this period “[t]he concentration of money held by private, powerful corporations exerted a disproportionate, if not all-consuming, influence on the legislature. . . . State government was characterized as ‘relatively unfettered state legislatures responding to powerful economic interests.’” Marritz, *supra* note 26, at 186–87. The legislature often sacrificed the public interest for private or personal interests. *Id.*

136. *Mesivtah Eitz Chaim of Bobov, Inc. v. Pike Cty. Bd. of Assessment Appeals*, 44 A.3d 3, 8 (2012).

137. S.B. 4, P.N. 347, Session of 2015 (Pa. 2015) (containing language that proposes to instead give the General Assembly the power to establish qualifications for determining institutions of purely public charity).

138. See *Donohugh’s Appeal*, 86 Pa. at 311; *White*, 42 A. at 125.

139. See *Donohugh’s Appeal*, 86 Pa. at 311–12. Prior to the Pennsylvania Constitution of 1874, the legislature granted charitable tax exemptions through special, discretionary, legislative grants. *Id.*



allowing this sort of complete discretion has proven to lead to favoritism.<sup>140</sup> What's more, such a result would likely lead to entities qualifying for charitable tax exemptions from property taxes when they are actually undeserving of that privilege.<sup>141</sup> In sum, granting power on the scale proposed and supposed of Senate Bill 4 might essentially mean unlimited power for the General Assembly.<sup>142</sup>

Several present-day facts support this concern that Senate Bill 4 may just lead to that type of legislative abuse. Many of the bill's strongest supporters are very large nonprofit organizations that have a lot of resources and power to devote to promoting their best political interest,<sup>143</sup> and have absolutely done just that in the past.<sup>144</sup> One news outlet reported on big tax-exempt institutions being "vigorous political players," claiming that, for example, "Highmark's [PAC] spent \$203,000 last year[.] . . . The hospital association's PAC spent \$198,000, and the association spent another \$1.08 million on lobbying. UPMC employees gave at least \$20,000 to the association's PAC, and made at least an additional \$113,000 in donations to other political committees and candidates."<sup>145</sup> Such an investment towards influencing the political agenda<sup>146</sup> is arguably the surest way to be certain that legislation remains (even unfairly) in their favor.<sup>147</sup> And such influence may exacerbate the issue with undeserving exemptions, especially since that was a perceived problem with Act 55<sup>148</sup> and Senate Bill 4 arguably purports to perpetuate Act 55.<sup>149</sup> In particular, Act 55 broadened both prongs (b) and (d) of the *HUP* criteria,<sup>150</sup> and specifically relaxed the pri-

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140. See discussion *supra* Part II.A.

141. *Donohugh's Appeal*, 86 Pa. at 311. Prior to the Pennsylvania Constitution of 1874, the legislature granted some charitable tax exemptions to corporations that were profit-motivated and not charitable at all. *Id.*; see also PA. DEP'T OF THE AUDITOR GEN., *supra* note 126 and accompanying text (stating that tax exemptions are "a privilege, not a right").

142. See *Donohugh's Appeal*, 86 Pa. at 311-12 (implying that when there is no restriction or general law otherwise restricting the legislature's power to exempt, that power can be unlimited).

143. See Lindstrom, *supra* note 12. Some of Senate Bill 4's largest supporters are organizations like UPMC, HAP, and Highmark. *Id.*

144. Potter & Lord, *supra* note 17.

145. *Id.*

146. *Id.*

147. Favoritism is a by-product of granting the General Assembly sole power in making tax-exemption determinations. See generally *Donohugh's Appeal*, 86 Pa. at 311.

148. Hamill & Silver, *supra* note 71 and accompanying text.

149. See discussion *supra* Part III.A.

150. See *Hosp. Utilization Project v. Commonwealth*, 487 A.2d 1306, 1317 (Pa. 1985); 10 PA. CONS. STAT. § 372-385, § 375(c)-(d) (1997).

vate profit motive prong by allowing institutions to spend considerable sums of money on compensation packages and advertising, but still qualify for exemption.<sup>151</sup>

Yet another fact in support of the belief that Senate Bill 4 may lead to legislative abuse is the plain language of the bill itself,<sup>152</sup> as well as the bill’s supporters’ stated intent to give the General Assembly ultimate authority.<sup>153</sup> For example, the intent to give the legislature the “exclusive role” in defining “institutions of purely public charity”<sup>154</sup> is arguably equal with intent to give the legislature unlimited authority. Both situations purport to eliminate or reduce the input of the court. This could likely not be the case because, as stated above, the Pennsylvania Supreme Court still has the power of constitutional interpretation over the phrase “institutions of purely public charity,” and it has shown that it can interpret that phrase more narrowly.<sup>155</sup> However, Senate Bill 4 remains troubling because, as history has shown, unlimited legislative power in this area of the law did in fact lead to legislative abuse.<sup>156</sup> As the balance of power between the legislature and the Pennsylvania Supreme Court remains in flux, there are genuine reasons to worry that that could be the case again.

#### IV. THE DEBATE OVER LOST REVENUE AND UNWARRANTED EXEMPTIONS

The concern over Senate Bill 4, possible legislative abuse, and allowing more supposed charitable institutions to qualify for property tax exemptions is fueled in part by (1) the growing distress over lost revenue due to property tax exemptions and (2) the belief that many organizations no longer warrant exemption.

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151. See 10 PA. CONS. STAT. §§ 372–385, § 375(c)(3) (1997) (noting that an institution operates entirely free from private profit motive when “[c]ompensation, including benefits, of any director, officer or employee, is not based *primarily* upon the financial performance of the institution”) (emphasis added); Prescott, *supra* note 12, at 993 (stating that Act 55 wholly broadens the issue of compensation of officers, directors and employees by leaving charities with “considerable flexibility in crafting compensation packages” to reward executives and employees based on the financial performance of the institution).

152. See S.B. 4, P.N. 347, Session of 2015 (Pa. 2015).

153. Memorandum, *supra* note 95. Senate Bill 4 is intended to “clarify that it is the exclusive role of the General Assembly to write laws providing for the qualifications of institutions of purely public charity.” *Id.*

154. *Id.*

155. Mesivtah Eitz Chaim of Bobov, Inc. v. Pike Cty. Bd. of Assessment Appeals, 44 A.3d 3, 7–9 (Pa. 2012).

156. White v. Smith, 42 A. 125 (Pa. 1899).

### A. *Lost Revenue from Charitable Property Tax Exemptions*

There is a very real concern today that property tax exemptions are causing an increasingly heavy burden to fall on municipalities and taxpayers.<sup>157</sup> One of the strongest arguments behind this concern is that when charitable organizations are granted exemptions from taxation, everyone else must pay more.<sup>158</sup> More specifically, in this scenario, because “property taxes are the main source of revenue for counties, municipalities, and school districts, exempt property decreases the total available taxable property that can generate revenue for these governments. This means that non-exempt, taxable properties bear a larger share of the total tax burden.”<sup>159</sup>

What’s more, taxable properties are also burdened with the responsibility of still paying to provide tax-exempt organizations with police protection, fire protection, and other public services.<sup>160</sup> This issue is also further exacerbated by the reality that many tax-exempt organizations are providing services to benefit people *outside* of the areas they are located,<sup>161</sup> similar to the problem encountered in *Mesivtah*.<sup>162</sup> For example, two common illustrations of this consequence are the realities that “hospitals normally serve an entire metropolitan area, not a single city; [and] many universities educate students from around the world. Yet the cost of the exemption is borne entirely by the municipality where the nonprofit is located.”<sup>163</sup> Now, it should be noted that this concern must be balanced against the good these institutions do for the communities

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157. See Kenyon & Langley, *supra* note 125, at 2 (explaining that “[f]or cities heavily reliant on the property tax, the exemption of nonprofits from property taxation means that homeowners and businesses must bear a greater share of the property tax burden”). This can be especially concerning during hard economic times and when tax-exempt nonprofits make up a significant portion of a municipality.

158. *Id.* See *Young Men’s Christian Ass’n of Germantown v. City of Phila.*, 187 A. 204, 210 (Pa. 1936) (“When any inhabitant fails to contribute his share of the costs . . . some other inhabitant must contribute more than his fair share of that cost.”).

159. ALLEGHENY CTY. CONTROLLER CHELSA WAGNER’S TAXPAYER ALERTS, *supra* note 9.

160. See *YMCA of Germantown*, 187 A. 204, 210 (Pa. 1936) (“Every inhabitant and every parcel of property receives governmental protection. Such protection costs money.”); Kenyon & Langley, *supra* note 125, at 2 (noting that “municipalities still need to pay to provide these nonprofits with public services like police and fire protection and street maintenance”).

161. Kenyon & Langley, *supra* note 125, at 8.

162. *Mesivtah Eitz Chaim of Bobov, Inc. v. Pike Cty. Bd. of Assessment Appeals*, 44 A.3d 3, 5 (2012).

163. Kenyon & Langley, *supra* note 125, at 8. See also Evelyn Brody, *All Charities are Property-Tax Exempt, but Some Charities are More Exempt Than Others*, 44 NEW ENG. L. REV. 621, 637 (2010) (discussing that a charity benefiting the public does not mean the benefit has to necessarily be geographic). However, such a reality provides a sound argument for the suggestion that the “relieves the government of some of its burden” prong in *HUP* should refer to the county, city, and schools whose taxes the exempt organization is *not* paying.

they are located in, such as revitalizing or generating other income for the area. Nevertheless, because these are tough economic times for local governments and individuals all around, it is easy to see why residents may be less than willing to continue supporting such large property-tax-exempt institutions.

Residents may be less than willing to continue supporting some of these institutions especially in light of figures which show just how much real estate certain tax-exempt institutions own. Non-profits own approximately “20 to 40 percent of properties located in Pennsylvania cities”<sup>164</sup>—quite a substantial amount. Additionally, other research has revealed that tax-exempt properties “account for about \$1.5 billion in untapped tax revenue” across the state.<sup>165</sup> It is important to note that this figure *does* include tax-exempt properties owned by the government, not just properties owned by tax-exempt institutions of purely public charity.<sup>166</sup> Therefore, one must consider that lost revenue due to tax-exempt properties is not entirely because of the tax-exempt status of non-profits.<sup>167</sup> Yet, one can get a sense of just how much the total potential property tax liability may be for institutions of purely public charity by examining medical facilities alone. In a report prepared by the Pennsylvania Department of the Auditor General in 2014, research showed that the total potential property tax liability for medical facilities with purely public charity status in 2014 amounted to over \$177 million for only ten counties in Pennsylvania.<sup>168</sup> As these are considerable amounts of money that the municipalities, and the activities they support, are losing out on, it is no wonder that there has been a much closer weighing of the good these tax-exempt charitable institutions do for the community versus what they cost it.

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164. Lindstrom, *supra* note 12.

165. *Id.*

166. *Id.*

167. *Id.* For example, in Allegheny County, the percentage of the total share of potential revenue that could be generated if tax-exempt properties were taxed is: 15.64% for County Government and 8.11% for Municipal Government. ALLEGHENY CTY. CONTROLLER CHELSA WAGNER'S TAXPAYER ALERTS, *supra* note 9, at 2.

168. PA. DEPT OF THE AUDITOR GEN., *supra* note 9, at 7. These ten counties include: \$76,124,321 for Allegheny County; \$2,675,644 for Beaver County; \$15,557,615 for Bucks County; \$16,512,001 for Dauphin County; \$7,181,931 for Erie County; \$6,280,067 for Lackawanna County; \$18,184,315 for Lehigh County; \$9,613,394 for Luzerne County; \$1,149,444 for Monroe County; and \$24,135,955 for Montgomery County. *Id.* These figures include “the sum of county, municipal, and school district taxes for parcels owned by medical facilities.” *Id.*

*B. The Concern That Some Charitable Property Tax Exemptions Are Unwarranted*

Close scrutiny of tax-exempt charities also exists particularly in light of a growing belief that many tax-exemptions are being granted to organizations underserving of them. Historically, there used to be a clearer distinction between for-profit institutions operating under an idea of profit maximization and non-profit institutions, which traditionally were not supposed to generate profits at all.<sup>169</sup> However, “[a]s society has evolved and as charitable segments within the nonprofit sector have modernized, notions of the types of activities that constitute charity have changed.”<sup>170</sup> As such, there is a tendency now for charitable institutions to look less like eleemosynary entities that give gratuitously and more like large for-profit corporations.<sup>171</sup>

Several characteristics of many of today’s tax-exempt charitable institutions have led to this belief. One consideration is the questionable level of charitable services actually being rendered. For example, research has shown that “uncompensated care provided by nonprofit hospitals for the most part may not be substantially distinguishable from that given by for-profit hospitals.”<sup>172</sup> This means that nonprofit hospitals are not providing substantially more free care than for-profit hospitals. Prong (b) of the *HUP* test, however, would mandate that the charitable organization donate or render gratuitously a *substantial* portion of its services.<sup>173</sup> One key allegation criticizing the hospital-giant UPMC’s tax-exempt status is that UPMC donates less than two percent of its revenue to needy patients.<sup>174</sup> Another criticism, primarily of hospitals, is based on the acknowledgement that there have been instances of hospitals

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169. Nina J. Crimm, *Why All is Not Quiet on the “Home Front” for Charitable Organizations*, 29 N.M. L. REV. 1, 21–23 (1999).

170. *Id.* at 21.

171. For example, in the case of hospitals, “[t]his change may have been fueled in part by the proliferation of mergers, acquisitions, joint ventures and conversions of nonprofit hospitals . . . into for-profits.” *Id.* at 23–24.

172. *Id.* at 22.

173. *Hosp. Utilization Project v. Commonwealth*, 487 A.2d 1306, 1317 (Pa. 1985) (emphasis added).

174. In 2013, Pittsburgh Mayor Luke Ravenstahl filed a lawsuit challenging the tax-exempt status of UPMC’s properties in Pittsburgh. Jeremy Boren & Bobby Kerlik, *Ravenstahl: Pittsburgh sues to remove UPMC’s tax-exempt status*, TRIBLIVE (Mar. 20, 2013), <http://triblive.com/news/adminpage/3696701-74/tax-upmc-exempt#axzz3JoVW24sN>. Among some of the allegations in the lawsuit against Western Pennsylvania’s largest health care system is that UPMC pays several of its executives seven-figure salaries; it has closed or scaled back operations that were underperforming; it donates less than two percent of its revenues to needy patients; and it acts as a for-profit, international corporation that has interests all over the world. *Id.*

closing facilities in order to maintain a good financial performance.<sup>175</sup> Because many hospitals were established in areas where there was a great need for medical services, it is understandable that their subsequent closures have left many with a feeling of abandonment—both literally and figuratively—regarding the organization’s supposed charitable purpose.<sup>176</sup>

Perhaps one of the most widely criticized characteristics of many charitable organizations today is what they pay their top executives. Sums have reached what many believe to be extraordinary levels, considering the longstanding requirement that institutions of purely public charity should operate without private profit motive.<sup>177</sup> For example, a study by the Urban Institute revealed that while “the typical chief executive received \$169,000 at non-profit hospitals and roughly \$114,000 at colleges and universities[,]” in some cases those numbers climbed into the millions.<sup>178</sup> In addition, many organizations also supplement high salaries with generous expense accounts and other allowances.<sup>179</sup> While it is certainly very true that many of these organizations must consider the need to keep salaries and benefits high in order to attract the best talent

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175. *Id.*

176. *Id.* See also Phil Galewitz, *Hospitals pack up in poor areas, move to wealthier ones*, CNNMONEY (May 1, 2015), <http://money.cnn.com/2015/04/20/news/economy/hospitals-relocating/> (quoting Gerard Anderson, director of the Center for Hospital Finance and Management at the Johns Hopkins Bloomberg School of Public Health as stating “[h]ospitals were established in inner cities where the greatest needs were and now, essentially, that charity obligation has gone by the wayside as they are looking at their bottom line[.]”).

177. See *HUP*, 487 A.2d at 1318. This criticism that charitable organizations are paying their executives too much also relates back to a criticism of Act 55. See Prescott, *supra* note 12, at 993 (noting that Act 55 wholly broadens the issue of compensation of officers, directors and employees by leaving charities with “considerable flexibility in crafting compensation packages” to reward executives and employees based on the financial performance of the institution).

178. Eric C. Twombly & Marie G. Gantz, *Executive Compensation in the Nonprofit Sector: New Findings and Policy Implications*, URBAN INST. 2 (Nov. 2001), <http://www.urban.org/sites/default/files/alfresco/publication-pdfs/310372-Executive-Compensation-in-the-Nonprofit-Sector.PDF> (“In select cases, chief executives at nonprofit hospitals and higher education institutions are paid more than 1.5 million[.]”). For example, one news outlet reported “UPMC lavishes more than 20 of its executives with seven-figure salaries, including President and CEO Jeffrey Romoff, who received nearly \$6 million in compensation in 2011. He made \$4 million in 2010.” Boren & Kerlik, *supra* note 174.

179. Twombly & Gantz, *supra* note 178, at 3. “[N]on-profits act like other firms by supplying some chief officers with expense accounts or other allowances to purchase housing, food, and clothing[.]” *Id.* For example, “UPMC rents the ‘most expensive office space’ in Pittsburgh in the U.S. Steel building for [CEO] Romoff, who has access to a ‘private chef and dining room, chauffeur and private jet.’” Boren & Kerlik, *supra* note 174.

possible, executive salaries reaching levels in the millions only perpetuate the concerns about many tax-exempt charitable institutions operating with a strong private profit motive.<sup>180</sup>

Similar arguments to those criticizing compensation revolve around the high figures charitable organizations spend on fundraising and the low figures spent on program expenses. Experts recommend that a charitable organization's fundraising costs not exceed thirty-five percent of the related contributions to an organization,<sup>181</sup> and that a charity's total expenses spent on the program and services it delivers hover around at least seventy-five percent.<sup>182</sup> One extreme example of a tax-exempt Pennsylvania charity clearly not meeting these basic recommendations is the Lower Paxton-based Children's Cancer Recovery Foundation—ranked as one of "America's Worst Charities."<sup>183</sup> This particular organization used professional fundraisers to raise \$34.7 million over ten years, but instead of using most of that money for its charitable mission, instead paid \$27.6 million to the fundraisers and had less than one percent going to direct aid.<sup>184</sup> While this may be considered a severe example, it nonetheless provides at least some validation for concerns about organizations claiming to be charitable, when that may be a fact that is clearly debatable.

While critics continue to point out flaws in the operations of today's charitable institutions, there are several counterarguments in support of tax-exempt nonprofit organizations. For example, some nonprofits might argue that they are providing services and bene-

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180. Prescott, *supra* note 12, at 993. High salary levels for executives at charitable institutions generate concerns about the charitable institution being greedy and looking like a for-profit institution. See Prescott, *supra* note 12 and accompanying text. This in turn may make the charitable institution look underserving of its tax-exempt status (if the organization is property-tax-exempt). *Id.*

181. Patrick Sullivan, *Survey: Charities Should Spend 23% On Overhead*, THENONPROFITTIMES (Aug. 15, 2012), <http://www.thenonprofittimes.com/news-articles/survey-charities-should-spend-23-on-overhead/>.

182. CHARITY NAVIGATOR, <http://www.charitynavigator.org/index.cfm?bay=content.view&cpid=470#P> (last visited Jan. 2, 2016). Charity Navigator is a leading organization dedicated to providing the public with detailed information about the operations of various charitable organizations in an effort to make people aware of how the money they donate is actually being used. CHARITY NAVIGATOR, <http://www.charitynavigator.org/index.cfm?bay=content.view&cpid=628#VvwmQcc0mu4> (last visited Mar. 30, 2016).

183. David Wenner, *Three central Pennsylvania charities portrayed negatively in investigative report*, PENN LIVE (June 17, 2013), [http://www.pennlive.com/midstate/index.ssf/2013/06/worst\\_charities\\_childrens\\_canc.html#incart\\_m-rpt-1](http://www.pennlive.com/midstate/index.ssf/2013/06/worst_charities_childrens_canc.html#incart_m-rpt-1).

184. *Id.*

fits that would exceed the amount the organization would be obligated to pay in property taxes if it was not exempted.<sup>185</sup> Such an argument combats the assertion that some organizations may not be donating or rendering gratuitously a substantial portion of their services. Additionally, specifically regarding the health care industry, since there are no public hospitals in Pennsylvania, the continual operation of nonprofit hospitals assures that care for the poor and underprivileged does not fall on the local government or taxpayers.<sup>186</sup> This argument necessarily leads to the conclusion that nonprofit hospitals are relieving the government of some of its burden.<sup>187</sup> Further, in response to the claim that many exempt organizations are actually operating *for* profit, almost any organization could make the argument that they must generate more in revenue than what they pay in expenses to avoid going out of business.<sup>188</sup> Yet suspicions surrounding an institution’s private profit motive and what services are actually being rendered gratuitously, among other things, continue to grow and are bolstered by the hard facts calling into question just how “charitable” some tax-exempt organizations may be.

## V. PROPOSED LIMITATIONS ON CHARITABLE PROPERTY TAX EXEMPTIONS

Given the real concern regarding the extent of property tax exemptions granted to charitable institutions today, Pennsylvania

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185. PA. DEPT OF THE AUDITOR GEN., *supra* note 72 (from the testimony of Tom McGough, Executive Vice President and Chief Legal Officer of UPMC, on March 12, 2015). In the case of UPMC:

Last year, Mercy [Hospital] provided the community with approximately \$53 million in free or uncompensated care per IRS guidelines. By contrast, the total amount of property taxes that would be paid on its exempt real estate would be \$4.9 million, or less than ten percent of that charity care. In fact, the \$53 million in free or uncompensated care Mercy provides by itself exceeds the \$48 million in property taxes the Auditor General’s report suggested all of UPMC’s hospitals would pay if their properties were put on the tax rolls.

*Id.*

186. *Id.* (from the testimony of Tom McGough, Executive Vice President and Chief Legal Officer of UPMC, on March 12, 2015). Specifically, “Pennsylvania is the only large state in the nation without public hospitals. As a result, the responsibility to provide medical care for Pennsylvania’s poor and underprivileged falls not upon taxpayers or local governments, as it does in many states, but rather upon nonprofit hospitals like UPMC Mercy.” *Id.* Public hospitals would cost hundreds of millions of dollars to establish and operate. *Id.*

187. *Id.*

188. *Id.* (from the testimony of Tom McGough, Executive Vice President and Chief Legal Officer of UPMC, on March 12, 2015) (stating that “[a]ll companies, whether for-profit or nonprofit, must try to generate more in revenues than they pay out in expenses if they want to avoid going out of business”).



should consider adopting some measures that offset or restrict existing exemptions to alleviate these anxieties. There are several responses available that could help to partially offset the impact of lost revenue on municipalities due to charitable tax exemptions, even though the Pennsylvania legislature has indicated a desire to do the exact opposite through Senate Bill 4. For example, some states have begun instituting user fees, where nonprofits pay fees for services like water, sewer, and garbage collection.<sup>189</sup> Similarly, some municipalities have also imposed municipal service fees, which are payments somewhere between a fee and a tax that can be charged solely to tax-exempt nonprofits, and that pay for public goods normally funded by taxes, like street maintenance.<sup>190</sup> Although these fees do not make up for the substantial sums of lost property tax revenue, they are a way for cities to recoup at least some money from organizations, while the charitable institutions retain their tax-exempt status.

One measure already used in Pennsylvania are Payments in Lieu of Taxes (PILOTs), which are voluntary payments made by tax-exempt nonprofits as a substitute for not paying property taxes.<sup>191</sup> PILOTs are typically negotiated between local governments and individual nonprofits, can be in the form of annual or one-time payments, and may go into a municipality's general fund or can be paid straight into a specific project or program.<sup>192</sup> While PILOTs can be critical in making up for lost revenue, negotiations can often become contentious and payments may be sporadic, since they are completely voluntary on the part of the charitable organization.<sup>193</sup> PILOTs can end up being very large sums of money, even into the millions, which makes them more on par with lost tax revenues; however, due to their voluntary nature, they are unreliable.

Yet other legislative actions are available for Pennsylvania to narrow the law or general scope of property tax exemptions for charitable institutions. In order to address the concern that organizations are paying their executives too much, the state could consider adopting a cap on executive compensation. A cap could ensure that

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189. Kenyon & Langley, *supra* note 125, at 5.

190. *Id.*

191. *Id.* at 6.

192. *Id.*

193. *Id.* "PILOTs can provide crucial revenue for certain municipalities and are one way to make nonprofits pay for the public services they consume." *Id.* "However, negotiations can become contentious, and the often ad hoc determination of payment amounts results in widely varying payments among similar nonprofits." *Id.* With existing conflicts between the HUP criteria and Act 55, and now Senate Bill 4, it is easy to imagine that any PILOT negotiations might easily become contentious.

compensation levels remain reasonable and that organizations do not lean more towards operating for private profit motive. However, instituting a cap would also lead to issues such as where should the cap be set at or the potential for limiting the ability of charitable organizations to attract top talent.<sup>194</sup> Similar to a cap on compensation, the state could also set a limit on what percent of its budget tax-exempt charitable organizations can spend on fundraising. Additionally, the state might go even further and set a minimum on the percentage of its budget an organization should spend on providing gratuitous services. Ensuring that organizations contribute at least a certain amount in free services would help to safeguard exemptions being granted to organizations that do indeed advance a charitable purpose and donate a substantial portion of their services gratuitously. If the Pennsylvania Legislature could be persuaded to set limits, whatever they may be, the public's concerns over undeserving charitable tax exemptions might easily be appeased.

State and local governments might also consider narrowing the scope of charitable property tax exemptions by "phasing out property tax exemptions after a certain period."<sup>195</sup> This approach recognizes the local government's interest in preventing the loss of this revenue stream indefinitely,<sup>196</sup> and might assuage local governments with the knowledge that they will receive money from the charitable organizations at some future point. In addition, Pennsylvania might limit the number of acres that can qualify for exemption, which could ensure that an organization's continued expansion "not be at the expense of local government."<sup>197</sup> Such a measure could be extremely effective when dealing with organizations like UPMC, for example, which consistently grow larger and larger. The state might also consider setting a dollar limit on the amount of property that can be tax-exempt.<sup>198</sup> This measure would protect against organizations continually receiving exemptions

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194. Prescott, *supra* note 12, at 993.

195. Gil A. Nusbaum, *Weighing the Options on State and Local Property Taxes*, 19 EXEMPTS 1, 5 (2007).

196. *Id.* at n.15. Specifically, this approach "would allow new organizations to get started without the burden of having to pay property tax, while also recognizing the local government's interest in not losing this revenue stream indefinitely. Furthermore, this option also allows the organization to plan for the eventual imposition of the property tax." *Id.*

197. *Id.* at n.16 ("This approach recognizes that there is a threshold reasonable level of property ownership beyond which further expansion should not be at the expense of local government.").

198. *Id.*

when they have such a good financial standing that no longer justifies further exemption.<sup>199</sup> While the key to many of these approaches is in adequately balancing the interests of the local governments with those of the tax-exempt charitable institutions,<sup>200</sup> they do represent very viable options for limiting charitable tax exemptions that would allow deserving institutions to maintain their tax-exempt status, while also ferreting out underserving organizations and allowing local governments to make up some of that lost tax revenue.

And though many of these proposals are appealing, there are arguably several reasons to take pause before adopting such restrictive measures. For example, it would be important to consider that if a charitable organization no longer qualifies for a tax exemption, it may be forced to cut services or benefits to the public in order to maintain its financial stability.<sup>201</sup> The community could thus lose out on a much needed or relied upon service. Further, if an organization cannot remain financially stable, it may be forced to close, in turn possibly forcing the taxpayers or local government to bear the burden of paying for the services the organization had offered.<sup>202</sup> This could overburden taxpayers already resentful of the burden tax-exempt organizations have placed on them. Additionally, imposing more regulations might strain an already tenuous relationship between those in favor of more exemptions and those against them, leading to less cooperation and an erosion of goodwill.<sup>203</sup>

Nevertheless, despite these possible repercussions, many of the measures discussed above do provide practical ways of meeting the concerns in this area of the law discussed throughout this comment. For example, imposing user and municipal fees could in part relieve “cash-strapped” municipalities, while imposing caps on compensation or acreage could provide the clarity and consistency applauded under Act 55 as well as the narrowness appreciated about the *HUP*

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199. *Id.* at n.17 (“This method would provide another way to balance the interests of tax-exempt organizations with those of local governments, with ownership of property beyond the ceiling indicating that the organization has a level of wealth or ability to pay that does not justify further exemption.”).

200. *Id.*

201. PA. DEPT OF THE AUDITOR GEN., *supra* note 72 (from the testimony of Patricia J. Raffaele, Vice President of Professional Services as Hospital Council of Western Pennsylvania, on March 12, 2015) (stating that “[i]ncreased costs to any healthcare provider can and will lead to lost jobs and reduced community services and benefits relied on by many individuals and their families”).

202. *Id.* (from the testimony of Tom McGough, Executive Vice President and Chief Legal Officer of UPMC, on March 12, 2015).

203. PA. DEPT OF THE AUDITOR GEN., *supra* note 72; *see also supra* text accompanying note 119.

criteria. Moreover, many of these measures could not only assuage concerns about lost tax revenue and undeserving exemptions, but they could provide that clarity, consistency, and narrowness—thus acting as a happy medium to satisfy everyone’s concerns.

## VI. CONCLUSION

Pennsylvania has been faced with many challenges regarding the concept of property tax exemptions for charitable institutions over the past 100 years. The current struggle for power between the Pennsylvania Supreme Court and the General Assembly, and tax-exempt nonprofits and municipalities, present some of the most complicated challenges yet. Senate Bill 4, however, is not the solution. Though the consequences of Senate Bill 4’s potential passage remain unclear,<sup>204</sup> one point of law that remains resolute is that the Pennsylvania Legislature may not cut out the Pennsylvania Supreme Court’s right to interpret the constitutional phrase “institutions of purely public charity.”<sup>205</sup> Such a proposal is misguided, and indeed worrisome, as the Pennsylvania Constitution of 1874 was expressly designed to limit legislative authority in granting tax exemptions.<sup>206</sup>

Instead of fighting the Pennsylvania Supreme Court and local governments through Senate Bill 4, the Pennsylvania Legislature should be looking at ways to compromise. Today’s concerns over lost tax revenue and unwarranted exemptions are real and unlikely to go away. Many of the more restrictive measures on charitable property tax exemptions suggested above could easily alleviate those concerns, and still provide benefits to the legislature and nonprofits such as clarity and consistency. While it is easy to get caught up in the political struggle surrounding the phrase “institutions of purely public charity,” it is critical to remember the fundamental principle that tax exemptions are a privilege.<sup>207</sup> Therefore, whatever future measures are adopted, or returned to, in defining “institutions of purely public charity,” as the Pennsylvania Supreme Court once so aptly stated, it remains essential “to reinforce

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204. Lindstrom, *supra* notes 100–103 and accompanying text.

205. Mesivtah Eitz Chaim of Bobov, Inc. v. Pike Cty. Bd. of Assessment Appeals, 44 A.3d 3, 7 (2012); *see also supra* text accompanying note 22.

206. Marritz, *supra* note 26, at 191.

207. PA. DEPT OF THE AUDITOR GEN., *supra* note 72 (from the testimony of Dean Emeritus Nicholas P. Cafardi, Professor of Law at Duquesne University School of Law, on March 12, 2015). “The Uniformity Clause of the Pennsylvania Constitution adds that the burden of paying taxes should fall equally on us all.” *Id.* “Accordingly, tax exemption is a privilege, not a right. When some of us do not pay taxes, the rest of us must pay more.” *Id.*

the traditional characteristics of charities rather than to expand their scope to the point that the term 'charity' is meaningless."<sup>208</sup>

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208. City of Wash. v. Bd. of Assessment Appeals of Wash. Cty., 704 A.2d 120, 126 (Pa. 1997).



